

IT 95-83

Tax Type: INCOME TAX

Issue: Penalty Under 1002(d) - Failure To File/Pay Withholding

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

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DEPARTMENT OF REVENUE      )
STATE OF ILLINOIS         )
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                           )   Docket:
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XXXXXX,                   )   James P. Pieczonka
                           )   Administrative Law Judge
Taxpayer(s)               )
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RECOMMENDATION FOR DISPOSITION

APPEARANCES: James P. Pieczonka, Administrative Law Judge presided at a Rehearing of the above matter in Chicago, Illinois. Department attorney, Sean Cullinan introduced the Department's prima facie case, Department of Revenue Exhibits 1-17. Taxpayer, appeared with his attorney of record, XXXXX.

SYNOPSIS: The instant case arose from a non-field IL-941 audit of Taxpayer A (hereinafter referred to as "TAXPAYER A") due to the failure of the business to remit withheld taxes of its employees to the Department. The Deficiency covered the 4th quarter of 1990 and the 1st and 2nd quarters of 1991 in the amount of \$21,493.00. It was determined that Illinois 941 returns were not filed for the quarters in question and the business did not remit the taxes due to the Department. Therefore, a Notice of Deficiency was issued to Taxpayer B (hereinafter referred to as "TAXPAYER B") as a responsible officer of the company pursuant to Section 1002(d). The Deficiency was issued on October 5, 1992 in the amount of \$21,493.00.

After Protest and a rehearing subsequent to a default hearing, the issue was resolved in part in favor of the Department.

The issue presented for review is:

Whether Taxpayer was a responsible officer/person of TAXPAYER A during the quarters in question, and thereby required to collect, truthfully account for and pay over the taxes due; and whether Taxpayer willfully failed to do so pursuant to Section 1002(d) of the Illinois Income Tax Act?

FINDINGS OF FACT:

1. TAXPAYER B was a 100% shareholder of TAXPAYER A prior to 1990. (Tr.p. 30) During the quarters in question he was the president and secretary, and a 67% shareholder of TAXPAYER A. TAXPAYER A was an Illinois corporation located at XXXXX in the business of book and catalog binding and had about 80 employees (Dept. Ex. No.'s 2-4; Tr. pp. 21-24). During the quarters in question, TAXPAYER B'S duties were to oversee production in the plant and make some sales calls. (Tr.p. 12) TAXPAYER C became a 33% shareholder and vice-president of TAXPAYER A in May of 1990, acted as sales manager and handled the accounts receivables and payables. (Tr. p. 11-12; 21)

2. The signatories on the operating account of TAXPAYER A during the quarters in question were TAXPAYER B, TAXPAYER C, TAXPAYER D, a bookkeeper, and TAXPAYER E, the previous bookkeeper and current production person. (Tr. p. 13) TAXPAYER A did not have a separate payroll account. (Tr. p. 24)

3. TAXPAYER E prepared the IL-941 returns and TAXPAYER C or TAXPAYER E would have signed checks and remitted the IL-941 returns and payments. (Tr. p. 13) TAXPAYER E signed the payroll checks and TAXPAYER C signed the checks to creditors at his own discretion. (Tr. p. 23) TAXPAYER B did not sign any checks to creditors during the quarters in question. (Tr. p. 27) TAXPAYER B had instructed TAXPAYER C to pay all taxes before any creditors. TAXPAYER B did not learn of the delinquent withheld taxes until the summer or fall of 1991. (Tr. p. 14) However, TAXPAYER B executed on May 10, 1991 (date of asset seizure by NBD), as president of TAXPAYER A, IL-941 forms for the following quarters:

Quarter	Dated	Amount
4/Q/90	5/10/91	\$11,284.64

1/Q/91	5/10/91	7,055.74
2/Q/91	5/10/91	3,151.60

(Dept. Ex. No. 6).

4. The business ceased operations on May 10, 1991 when the business assets and accounts of TAXPAYER A were seized by TAXPAYER F (hereinafter "TAXPAYER F") under the terms of various loan agreements. TAXPAYER F changed the locks and did not allow TAXPAYER B to enter the premises. (Tr. p. 28) Also, TAXPAYER F instructed TAXPAYER B not to issue the payroll checks on May 10, 1991. (Tr. p. 16) Due to the seizure of the accounts and assets, checks in payment of taxes to the IRS and creditors were not cleared by TAXPAYER F (Dept. Ex. No.'s 3,5; Tr. p. 15).

5. On June 26, 1991, TAXPAYER F conducted a sale of all the assets of TAXPAYER A. (Dept. Ex. No. 3) All the proceeds of the sale were retained by TAXPAYER F to repay their loans. (Tr. p. 17) Later, TAXPAYER F sold the TAXPAYER A property which was also owned by TAXPAYER B and retained all the funds from the property. (Tr. p. 19)

6. On October 5, 1992, the Department issued a Notice of Deficiency to TAXPAYER B pursuant to Section 1002(d) of the IITA regarding the unpaid withheld taxes of TAXPAYER A for the 4th quarter of 1990 and the first two quarters in 1991 in the amount of \$21,437.00. (Dept. Ex No. 2)

7. On December 4, 1992 a Protest was timely filed by TAXPAYER B. He contended that he did not participate in the decision by TAXPAYER F to seize the business assets or bank accounts and was prevented by the seizure of the assets from remitting the withheld taxes due to the Department for the quarters in question, therefore non-payment of the withheld taxes was not willful. Additionally, a fire and theft of records from the premises of TAXPAYER A prevented TAXPAYER B from preparing and filing the second quarter IL-941 returns for 1991. (Dept. Ex. No. 3; Tr. p. 19)

8. On December 14, 1993, a hearing was held before Administrative Law Judge, James P. Pieczonka in Chicago, Illinois. Neither TAXPAYER B nor his attorney of record appeared to rebut the Department's prima facie case.

Consequently, a default order was entered. TAXPAYER B filed a timely request for Rehearing. (Dept. Ex. No. 13) A rehearing was held on June 24, 1994. (Dept. Ex. No. 14)

9. TAXPAYER B believed that all of TAXPAYER A'S taxes had been paid as of the date of the seizure by TAXPAYER F on May 10, 1991. Additionally, TAXPAYER A did not have any assets at the time TAXPAYER B learned of the subject deficiency after the seizure by TAXPAYER F. (Tr. pp. 20; 32) Although TAXPAYER B knew that TAXPAYER A was experiencing financial difficulties in late 1990 and had weekly meetings with TAXPAYER C, he did not discuss accounts payables or taxes with him or TAXPAYER E because they were TAXPAYER C's responsibilities. Also, TAXPAYER B did not review any balance sheets or financial statements because TAXPAYER A'S accounting service did not prepare them due to nonpayment of their fees. (Tr. pp. 26-32)

CONCLUSIONS OF LAW: The Administrative Law Judge finds that the Notice of Deficiency is prima facie correct and that TAXPAYER B was a responsible officer of TAXPAYER A during the quarters in question. Additionally, TAXPAYER B'S failure to withhold and remit the withheld taxes due the Department was willful for the 4th quarter of 1990 and the first quarter of 1991. However, due to the seizure by TAXPAYER F on May 10, 1991, TAXPAYER B did not willfully fail to remit the withheld taxes for the 2nd quarter of 1991. Consequently, TAXPAYER B has rebutted the Department's case as to willfulness for the 2nd quarter of 1991. Therefore, the Notice of Deficiency must be upheld for the 4th quarter of 1990 and the 1st quarter of 1991, but withdrawn for the 2nd quarter of 1991.

Section 1002(d) of the Illinois Income Tax Act provides:

Willful failure to collect and pay over Tax. Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. The penalties provided under subsections (a) or (b) shall not be imposed for

any offense to which this subsection applies. For purposes of this subsection, the term "person" includes an individual, corporation or partnership, or an officer or employee of any corporation (including a dissolved corporation), or any member or employee of a partnership, who as such officer, employee or member is under a duty to perform the act in respect of which the violation occurs.

35 ILCS 5/1002(d).

To be liable for penalties under Section 1002(d):

- (1) The taxpayer must be found to be responsible as an officer or person to collect and remit the withheld taxes; and
- (2) The failure to remit must be willful.

The Notice of Deficiency issued in this case is prima facie correct so long as its proposed assessment meets some minimum standard of reasonableness, *Vitale v. The Illinois Department of Revenue*, 118 Ill. App. 3d 210, 454 N.E. 2d 799, 73 Ill. Dec. 702 (1983). In order to overcome the prima facie correctness, the Taxpayer has the burden of presenting competent evidence that the proposed adjustments are incorrect, *Masini v. Department of Revenue*, 60 Ill. App. 3d 11, 376 N.E. 2d 324 (1978).

In the instant case the subject Notice of Deficiency was issued subsequent to a non-field audit of the business. TAXPAYER B filed a Protest contending that he was not responsible for the nonpayment of the withheld taxes and that he did not willfully fail to remit said taxes due to the seizure of the business assets by TAXPAYER F on May 10, 1991 and due to the loss of records from a fire.

The record showed that TAXPAYER B was the majority shareholder, president and secretary of TAXPAYER A. He was a signatory on the operating account of TAXPAYER A and executed IL-941 returns in the amounts as stated in the Notice of Deficiency. Consequently, TAXPAYER B was a responsible officer of TAXPAYER A. Merely delegating his responsibilities to bookkeeping employees or other officers does not absolve him of being a responsible officer of TAXPAYER A.

Having met the responsibility test of Section 1002(d), the issue of willfulness must be addressed. Although TAXPAYER B contends that he did

not have knowledge of the delinquent withheld taxes for the quarters in question until late 1991, the record shows otherwise. Department Exhibit 6 discloses that TAXPAYER B executed IL-941 returns for the quarters in question on May 10, 1991. Surely he must have known of the delinquency at that time.

Moreover, the administrative law judge finds it hard to believe that a majority shareholder of a family owned business did not review financial records or discuss accounts payables or tax payments with his vice-president during a period of financial hardships. Again, TAXPAYER B cannot ignore his responsibility for the withheld taxes by his reckless disregard for the payment of withheld taxes. TAXPAYER B'S statements as to non-payment of creditors, failure to direct TAXPAYER C as to payment of creditors and lack of knowledge of the delinquencies were self-serving.

Additionally, the seizure of the assets of TAXPAYER A took place subsequent to the due date for payment of the withheld taxes for the 4th quarter of 1990 and the 1st quarter of 1991. TAXPAYER B did not offer sufficient evidence that he was not responsible for their payment and that he did not willfully fail to remit them. Consequently, TAXPAYER B has failed to rebut the Department's case as to willfulness for the 4th quarter of 1990 and the 1st quarter of 1991.

As to the 2nd quarter of 1991, TAXPAYER B did not willfully fail to remit the withheld taxes to the Department. TAXPAYER F bank seized the books and records, assets and accounts of TAXPAYER A on May 10, 1991 and closed its doors. Such action by TAXPAYER F prevented TAXPAYER B from to remitting payment of the withheld taxes for the 2nd quarter of 1991. TAXPAYER F required TAXPAYER B to execute IL-941 returns for the quarters in question, however, TAXPAYER F did not remit the withheld taxes with the funds on hand at that time. Consequently, TAXPAYER B did not willfully fail to remit the withheld taxes for the 2nd quarter of 1991. Therefore, the Notice of Deficiency should be withdrawn for the 2nd quarter of 1991.

RECOMMENDATION: The Administrative Law Judge recommends to the Director of Revenue that TAXPAYER B was a responsible officer for the unpaid withheld taxes of TAXPAYER A and willfully failed to remit said taxes for the 4th quarter of 1990 and the 1st quarter of 1991. However, he did not willfully fail to remit the withheld taxes for the 2nd quarter of 1991. Therefore, the Notice of Deficiency must be upheld for the 4th quarter of 1990 and the 1st quarter of 1991, but should be withdrawn as to the 2nd quarter of 1991.

James P. Pieczonka
Administrative Law Judge

Date